Supreme Court, U.S.
FILED

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No.

In The

Supreme Court of the United States

October Term, 1996

SAMUEL M. DESARNO; ALICE DESARNO,

Petitioners,

v.

COUNTY OF ALLEGHENY; PENN HILLS SCHOOL DISTRICT,

Respondents.

GARY GAERTNER,

Trustee.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Petitioners Samuel M. DeSarno and Alice DeSarno proposed to pay over time the tax claims of Respondents Allegheny County and Penn Hills School District at a market rate of interest and not at the statutory rates, 12% and 10% respectively, set by Pennsylvania statute.

The market rate proposed by the DeSarnos was accepted by the Bankruptcy Court and their Chapter 13 Plan was confirmed over the objections of the Respondents. The District Court affirmed the decision of the Bankruptcy Court and the Third Circuit reversed. The question presented here is:

Does a market rate set according to local market conditions satisfy the present value rule of 11 U.S.C. § 1325(a)(5)(B)(ii)?

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PETITION FOR WRIT OF CERTIORARI

Samuel M. DeSarno and Alice DeSarno ("DeSarnos") respectfully pray that a writ of certiorari issue to review the judgment and opinion the United States Court of Appeals for the Third Circuit entered in this proceeding on July 30, 1996, in order to resolve the conflict between the Third and the Ninth, Eighth and Eleventh Circuit Courts of Appeals on the important issue presented herein.

OPINIONS BELOW

The Opinion of the United States Court of Appeals for the Third Circuit that gives rise to this petition is found at 89 F.3d 1123. It is reprinted in Appendix hereto at page App 1.

JURISDICTION

DeSarno, the lead case, was consolidated with three other Chapter 13 cases which sought to pay delinquent Allegheny County and Penn Hills School District real estate taxes through their respective Chapter 13 Plans. In each case, Allegheny County filed proofs of claim as a secured creditor asserting that a 12% statutory rate of interest should be provided. In all cases, the debtors filed an objection to the proof of claim on the grounds that the respective claims of the County and School District were modifiable pursuant to the terms of the 11 U.S.C. § 1322(b)(2) and should be paid post-petition interest at a

rate that reflects current market conditions in order to assure them of the present value of their claims over a repayment period, as required by 11 U.S.C. § 1325(a)(5)(B)(ii).

On May 13, 1994, the United States Bankruptcy court for the Western District of Pennsylvania issued a Memorandum Decision that Allegheny County's and Penn Hill School District's claims are modifiable pursuant to the provisions of 11 U.S.C. § 1322(b)(2) and set a rate of interest based on market conditions. Allegheny County and Penn Hills School District filed a notice of appeal to the United States District Court for the Western District of Pennsylvania. Related but separate cross-appeals on the issue of pre-petition interest were also filed in the *Rankin, Johnson,* and *Bonacci* cases.

In a Memorandum Opinion dated December 6, 1994, the District Court affirmed the decision of the Bankruptcy Court. Appeals and cross-appeals were again taken to the Third Circuit Court of Appeals. In a July 30, 1996 Opinion, the Third Circuit affirmed the district court's award of pre-petition interest at the statutory rates and, while agreeing on the issue of modifiability of the claims of Allegheny County and Penn Hills School District, nonetheless reversed on the issue of post-petition interest holding that the County and Penn Hills are entitled to the statutory interest rate on post-petition as well as pre-petition claims.

The jurisdiction of the Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTES INVOLVED IN THE CASE

11 U.S.C. § 1322(b)(2)

11 U.S.C. § 1325(a)(5)(B)(ii)

Text provided in Appendix at App. 63 and App. 65, respectively.

STATEMENT OF THE CASE

On June 25, 1993, the DeSarnos filed a Voluntary Chapter 13 Bankruptcy Petition listing as creditors, among others, the County of Allegheny and the School District of Penn Hills with real estate tax debt of $1,140.04 and $1,548.10, respectively. The Debtors filed their Chapter 13 Plan on July 13, 1993 and a Confirmation Hearing was held on September 15, 1993 at which time the Bankruptcy Court confirmed the Plan as an Interim Amended Chapter 13 Plan subject to the resolution of the tax claims and scheduled another hearing for November 17, 1993.

The Debtors filed for Chapter 13 protection in an effort to protect their residence from foreclosure by Associated Financial Services. Due to the limited income of the Debtors, the Debtors proposed a Plan to pay over time the taxes owed to the County of Allegheny and School District of Penn Hills, to cure the mortgage arrears owed to their Mortgage Company and to pay nothing to general unsecured creditors. All of the Debtors' available resources are utilized in making Plan payments to Secured and Priority creditors with no distribution expected to several Unsecured Creditors.

At a November 17, 1993 Hearing, the Bankruptcy Court confirmed the Debtors' Second Amended Chapter 13 Plan contingent on a final resolution of the tax issues concerning Allegheny County and Penn Hills School District. During the November 17, 1993 hearing, the County of Allegheny and Penn Hills School District objected to their treatment alleging that they were entitled to receive 12% and 10% interest respectively on their claims pursuant to certain provisions of the Pennsylvania Municipal Code. The Debtors argued that both creditors should only be paid 7% interest on their claims based on two facts: (a) that 11 U.S.C. § 1322 permits modification of the claim of Allegheny County and Penn Hills interests claims and (b) that the creditors should only be paid a *reasonable* interest rate which would allow Allegheny and Penn Hills not to lose the present value of their claim despite their being paid over a period of time pursuant to the provisions of 11 U.S.C. § 1325(a)(5)(B)(ii). In order to ensure that the County and School District would not lose the present value of their claims, the Debtors proposed the then commercial market rate for the District, or 7%.

The Bankruptcy Court further ordered that the parties file legal briefs supporting their respective positions concerning the applicable interest rate. The Bankruptcy Court did not schedule oral arguments on the legal merits or an evidentiary hearing but rather decided the issue of the applicable interest rate based upon the parties' briefs.

By Order and Memorandum Opinion of the Bankruptcy Court, the Honorable Joseph L. Cosetti, on May 13, 1994, Ordered that the Debtors may properly modify the post-petition interest due on the secured claims of the School District and the County. Further, using a "cost of

funds" approach, the Bankruptcy Court Ordered that the Debtors may pay the School District post-petition interest at a rate as low as 4.3% and that the Debtors may pay the County post-petition at a rate as low as 4.05%. The rates, which were proposed in related cases, were based on the rates at which the respective municipalities were able to borrow funds on the bond market fund to replace the lost tax revenues for that particular year, hence the "cost of funds" approach. Because the DeSarnos' Plan provided for interest at a higher market based rate, the Bankruptcy Court entered an Order confirming their Plan in May 1994.

Upon the final Confirmation of the Plan, the County and School District sought review of the Plan in the District Court, which affirmed the bankruptcy court's decision in a Memorandum Opinion dated December 6, 1994. In a July 30, 1996 Opinion, the Third Circuit affirmed the District Court's award of pre-petition interest at the statutory rates and reversed on the issue of post-petition interest, holding that the County and Penn Hills are entitled to the statutory interest rate on post-petition as well as pre-petition claims.

REASON FOR GRANTING THE WRIT

I. The Third Circuit's Opinion Directly Conflicts With The Ninth Circuit's Ruling in *In re Camino Real Landscape Maintenance Contractors, Inc.*, 818 F.2d 1503 (9th Cir. 1987), The Eighth Circuit's Ruling in *United States vs. Neal Pharmacal Co.*, 789 F.2d 1283 (8th Cir. 1986) and The Eleventh Circuit's Ruling in *In re Southern States Motor Inns, Inc.*, 709 F.2d 647 (11th Cir. 1983), cert. denied, 465 U.S. 1022, 104 S.Ct. 1275, 79 L.Ed.2d 680 (1984) And Is Contrary To The Plain Language Of Section 1325(a)(5)(B)(ii) Regarding Present Value Of Oversecured Claims.

The decision below is in direct conflict with the Ninth Circuit's decision in *In re Camino Real Landscape Maintenance Contractors, Inc.*, 818 F.2d 1503 (9th Cir. 1987), the Eighth Circuit's decision in *United States vs. Neal Pharmacal Co.*, 789 F.2d 1283 (8th Cir. 1986) and the Eleventh's Circuit's decision in *In re Southern States Motor Inns, Inc.* 709 F.2d 647 (11th Cir. 1983), cert. denied, 465 U.S. 1022, 104 S.Ct. 1275, 79 L.Ed.2d 680 (1984). Certiorari is appropriate here.

The Ninth Circuit in *Camino Real*, the Eighth Circuit in *Neal Pharmacal* and the Eleventh Circuit in *Southern States* in interpreting a virtually identical question of what constitutes present value[1] both "reject[ed] the

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[1] The foregoing cases treat Chapter 11 plans and not Chapter 13 plans, as in the instant case; however, the present value language in Section 1129(b)(2)(A)(i)(II) is virtually identical to the language of Section 1325(a)(5)(B)(ii), and has been treated as such in the instant case by the Third Circuit. *See* Opinion below, App. 17, note 7.

government's argument[2] that it is entitled to interest at the [statutorily set] rate on tax payments deferred under [the bankruptcy code]" 818 F.2d. at 1508 and accepted the notion of using a prevailing market rate for determing a fair present value paid over time. Further, the plain language and subsequent interpretations of 11 U.S.C. § 1325(a)(5)(B)(ii) clearly establishes that the holder of an allowed secured claim is entitled to receive, under the plan provision, what results in the present value of the claim over the repayment period. In direct contrast to the Ninth Circuit, the Court below looks exclusively to the statutory interest for a determination of present value and dismisses other methods on the basis that they are administratively inefficient.

All of the Court's below have held that the claims of the County and School District are modifiable pursuant to the provisions of Section 1322(b)(2), or, more precisely, that their respective claims do not fall within the narrow exception to modifiability of "a claim secured only by a security interest in real property that is the debtor's principal residence", 11 USC § 1322(b)(2). The basis of the lower courts' ruling has consistently been that a statutory lien does not fall within the purview of the term "security interest"; " 'security interest' means lien created by an agreement." 11 U.S.C. § 101.

There has been wide disagreement, however, regarding what interest rate to apply in order to assure the taxing authorities of the present value of their claim, to

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[2] In *Camino Real* the government consisted of the Internal Revenue Service and the claim consisted of primarily of tax claims secured by tax liens.

which present value they are entitled under the provisions of 11 U.S.C. § 1325(a)(5)(B)(ii). Save the Court of Appeals below, each of the lower courts in the instant case have applied a "cost of funds" approach to determining the rate at which the municipalities should be paid. The "cost of funds" approach, introduced by the debtors in the related *Rankin*, *Johnson*, and *Bonacci* cases, is based on the municipalities' ability to borrow the present lost revenues at a significantly reduced rate of interest, allows the municipalities to have their present value today, but also puts the onus on the municipalities to seek the present value of which the debtors deprived them. The Third Circuit, ostensibly for the sake of judicial economy, rejects not only the "cost of funds" approach, but also the equally administratively efficient and certainly more judicious true present value approaches of the DeSarnos, the dissent below and the Ninth, Eighth and Eleventh circuits.

The DeSarnos have proposed that 11 U.S.C. § 1325(a)(5)(B)(ii) requires that the present value of the oversecured creditor's claim not be compromised simply because payment is made over a period of time, and not all at once. In the case of a commercial creditor the present value will take into account the fact that the creditor expects to make a profit from the money it had lent to the debtor, and that if that commercial creditor did receive the full amount of its claim all at once, that creditor in turn would have those funds available to lend to another customer from which the creditor would make a profit. Since the commercial creditor is not receiving all of the money due at once, then Section 1325(a)(5)(B)(ii) must be read to allow that creditor to receive a profitable

post-petition interest rate so that its claim is not compromised due to being paid over a period of time.

In the instant matter, the moneys owed to the respective municipalities is not money which the municipalities expect to lend out in order to make a profit. Rather, it is money which they expect to spend in order to provide goods and services to their respective residents. It is the source of the funds which constitute their operating budgets for the year in which it is due.[3] Thus, the value for these municipal creditors has no relation whatsoever to the capacity of using money for the purpose of making a profit. Instead, the true present value of this debt to the County and School District is measurable in terms of a basket of goods and services which the County and School District could purchase today. In order to assure a true present value over time then, interest must be added to the debt in accordance with the inflationary rate for that basket of goods and services which the County and School District provide to their respective constituencies and some provision must also be made for the administrative cost of delaying the provision of those goods and services.

The DeSarnos recognize that making a determination based on the above is unfortunately far from judicially economical. Thus, the DeSarnos have suggested the use of an available market rate. Keeping in mind that a

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[3] Most likely, it is for this reason that the bankruptcy court held that the "cost of funds" approach is appropriate for a municipality as, deprived of the instant funds for a given fiscal year, the municipality *must* borrow on the bond market in order to make its operating budget.

municipality is not in the business of lending money for the purpose of making money, the use of a market rate not only insures that the municipality is kept whole despite the effects of inflation and costs of administrative delays, but also invariably provides some profit to the municipality for money on which it otherwise would not have profited.

The County and School District would argue that not allowing the application of the rate provided for by statute acts as a windfall to the Debtors and encourages the non-payment of taxes. Such a position belies both the relationship between Debtors and municipal creditors and the nature of the Chapter 13 process. The Debtors are not borrowing from the municipality, just as the municipality is not lending to the Debtors. The Debtors have filed a Chapter 13 Bankruptcy and are obligated not only to include all of their debts in the bankruptcy, but to pay all of their disposable income into the Chapter 13 Plan over a period of years. It is not as though these Debtors might prefer to pay another creditor over the instant creditor because of a less advantageous interest rate: not only are there no funds available to do so, the plan of repayment has already been scheduled for the next several years with regard to relatively well-defined classes and priorities which determine when each type of creditor will be paid, with little regard to the interest rate.

For these reasons, the Eighth, Ninth and Eleventh Circuits have taken the better approach. Although different statutes are treated, the language and reasoning are identical. In the instant case, the Third Circuit has decided that the statutorily set rate is the proper rate, where the Eighth, Ninth and Eleventh Circuits have

expressly rejected the statutorily set rate and adopted the market rate approach. The conflict is clear and irreconcilable. Certiorari is appropriate.

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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APPENDIX

Filed July 30, 1996

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

NO. 95-3007

LAURA RANKIN; DAVID RANKIN; STACY JOHNSON; ALICE BONACCI,

Appellants,

v.

SAMUEL M. DESARNO; ALICE DESARNO; COUNTY OF ALLEGHENY; PENN HILLS SCHOOL DISTRICT

GARY J. GAERTNER,
Trustee

COUNTY OF ALLEGHENY and PENN HILLS SCHOOL DISTRICT,

Appellants.

NO. 95-3037

LAURA RANKIN; DAVID RANKIN; STACY JOHNSON; ALICE BONACCI

v.

SAMUEL M. DESARNO; ALICE DESARNO; COUNTY OF ALLEGHENY; PENN HILLS SCHOOL DISTRICT

GARY J. GAERTNER,

Trustee

STACY JOHNSON,

Appellant.

NO. 95-3011

COUNTY OF ALLEGHENY; PENN HILLS SCHOOL DISTRICT,

Appellants,

v.

SAMUEL M. DESARNO; ALICE DESARNO

GARY J. GAERTNER, ESQUIRE,

Trustee.

On appeal from the United States District Court
for the Western District of Pennsylvania
(Civil Action Nos. 94-982 and 94-1174)

Argued: November 20, 1995

BEFORE: BECKER, SAROKIN and WELLFORD,*
Circuit Judges

(Opinion filed July 30, 1996)

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* Honorable Harry W. Wellford, United States Court of Appeals for the Sixth Circuit, sitting by designation.

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OPINION OF THE COURT

WELLFORD, *Circuit Judge:*

I. OVERVIEW

The primary dispute in this appeal concerns the rate of postpetition interest to which plaintiffs, the Penn Hills School District and Allegheny County, Pennsylvania, are entitled in connection with their oversecured prepetition tax claims against the defendants, numerous Chapter Thirteen bankruptcy debtors. Plaintiffs contend that interest should accrue at the applicable rates set forth in the Pennsylvania Municipal Code, and thus, that the bankruptcy and district courts erred in approving defendants' bankruptcy plans, which proposed to pay postpetition interest at a substantially lesser rate. Having carefully considered this issue and the others presented in this appeal, we **AFFIRM** in part and **REVERSE** in part.

II. STATEMENT OF THE CASE

Samuel and Alice DeSarno, Laura and David Rankin, Stacy Johnson, and Alice Bonacci defaulted on real estate taxes owed to Allegheny County and the Penn Hills School District. Because the salient facts are identical as to each defendant, we limit our background discussion to the DeSarnos. After the Desarnos defaulted on their tax obligations, plaintiffs filed secured claims against their principal residence in the approximate amount of $4,500. Under Pennsylvania law, these claims constitute first liens on the property and plaintiffs are entitled to receive

interest on the underlying debts at certain statutorily prescribed rates. The DeSarnos' residence is worth many times the amount of the principal debt plus interest; thus, plaintiffs' claims are substantially oversecured.

In June 1993, to avoid a foreclosure on their house, the DeSarnos filed a voluntary petition for bankruptcy under Chapter Thirteen of the United States Bankruptcy Code. The DeSarnos subsequently filed a plan proposing to pay in full plaintiffs' prepetition claims (100 percent of the principal debt plus interest at the statutory rates), but proposing to pay *postpetition* interest at a rate much lower than those prescribed by the relevant Pennsylvania statutes.

In November 1993, the bankruptcy court confirmed the DeSarnos' plan subject to a determination of the appropriate postpetition interest rate. The bankruptcy court directed the parties to file briefs supporting their respective positions, but did not schedule oral argument or conduct an evidentiary hearing on the matter. Allegheny County and Penn Hills argued at the confirmation hearing that they were entitled to interest at twelve and ten percent per annum, respectively, pursuant to Pennsylvania statutes. The DeSarnos, on the other hand, argued that plaintiffs' postpetition claims were modifiable under 11 U.S.C. § 1322(b)(2) and that postpetition interest should be set to accrue at a "reasonable" rate, as opposed to the statutory rates.

In May 1994, the bankruptcy court confirmed the DeSarnos' plan in its entirety, holding that plaintiffs' claims were modifiable and that the proposed rate of postpetition interest met and exceeded the rate that the

court determined to be reasonable. Thereafter, plaintiffs sought review of the plan in the district court. Notwithstanding initial concern over the bankruptcy court's failure to hold an evidentiary hearing to aid in its determination of an appropriate interest rate, the district court affirmed the bankruptcy court's decision. This timely appeal ensued. Defendant Stacy Johnson subsequently filed a cross-appeal challenging the applicable rate of *prepetition* interest for Allegheny County.

III. ISSUES ON APPEAL

The following issues are before us in this appeal and cross-appeal: (1) whether it was error to determine that Allegheny County is entitled under Pennsylvania statutory law to *prepetition* interest at a rate of twelve percent per annum; (2) whether the lower courts erred in holding that a tax claim secured by a statutory lien on a Chapter Thirteen debtor's principal residence is modifiable pursuant to 11 U.S.C. § 1322(b)(2); and (3) if so, whether the reduced rate of postpetition interest approved by the lower courts provides plaintiffs with the "present value" of their claims pursuant to 11 U.S.C. § 1325(a)(5)(B)(ii).

IV. STANDARD OF REVIEW

We review the bankruptcy court's findings of fact for clear error. *Sharon Steel Corp. v. National Fuel Gas Distrib. Corp.*, 872 F.2d 36, 38 (3d Cir. 1989). We exercise plenary review, however, in regard to the bankruptcy court's "choice, application and interpretation of legal precepts." *Id.* at 38-39.

V. DISCUSSION

A. Prepetition Interest

We first address whether the bankruptcy court correctly determined that Allegheny County is entitled to prepetition interest on its tax claims at a rate of twelve percent under Pennsylvania law. Although most of the defendants have conceded this point, defendant Johnson argues that the county is entitled to a maximum interest rate of only ten percent. We disagree.

Pursuant to 72 PA. CONS. STAT. ANN. § 5648, "second class" Pennsylvania counties[1] are entitled to interest on all county tax delinquencies and may adopt a maximum interest rate of twelve percent per annum on these debts.[2] It is undisputed that Allegheny County is the only "second class" county for purposes of § 5648 and that its County Commissioners have chosen to charge tax debtors the maximum amount allowed under that statute. Nevertheless, Johnson argues that § 5648 conflicts with and is governed by 53 PA. CONS. STAT. ANN. § 7143,[3] which

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[1] The counties in Pennsylvania are divided into nine separate classes based on population. 16 PA. CONST. STAT. ANN. § 3210.

[2] Section 5648 provides, in pertinent part, that "[i]n counties of the second class, all county taxes after the same become delinquent, as now provided by law, shall bear interest from the time said taxes become delinquent at a rate determined by the county commissioners not to exceed twelve per centum per annum until paid. . . . "

[3] Section 7143 states, in relevant part, that:

> Where the provisions of any other act relating to claims for taxes . . . utilizes the procedures provided

provides that interest claims made by municipalities for unpaid taxes cannot exceed ten percent per annum.

We agree that § 7143 conflicts with § 5648, but we do not find § 7143 to be controlling. Notwithstanding Johnson's assertions to the contrary, § 5648 is the more specific of the two statutes because it deals with tax delinquencies in second class counties. Further, the ten percent interest rate of § 7143, established by an amendment dated October 29, 1981, *predates* the twelve percent interest rate of § 5648, which was established on May 5, 1982. *See* Pa. Laws 319, No. 113, § 1; Pa. Laws 372, No. 106, § 1. Section 1933 of the Pennsylvania Statutory Construction Act of 1972 provides:

> Whenever a general provision in a statute shall be in conflict with a special provision in the same or another statute, the two shall be construed, if possible, so that effect may be given to both. If the conflict between the two provisions is irreconcilable, *the special provisions shall prevail and shall be construed as an exception to the general provision*, unless the general provision shall be enacted later and it shall be the manifest intention of the General Assembly that such general provisions shall prevail.

1 PA. CONS. STAT. ANN. § 1933 (emphasis added). Based on § 1993, the special provision allowing twelve percent

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> for in this act and where the provisions of such other act establishes a different rate of interest for such claims or liens, the maximum rate of interest of ten per cent per annum as provided for in this section shall be applicable to the claims and liens provided for under such acts. . . .

interest to second class counties embodied in § 5648 prevails over the general provision of § 7143 and must be construed as an exception to it.

To summarize, § 5648 is inconsistent with § 7143 because it specifically empowers the Allegheny County commissioners to establish an interest rate of up to twelve percent on delinquent taxes. Section 7143, on the other hand, provides for a maximum rate of only ten percent. Thus, the two statutes are in conflict because they *authorize* different rates. The commissioners, taking advantage of the full authorization of § 5648, established the applicable rate at twelve percent. We believe that § 5648 – the later, more specific statute – controls here. Accordingly, we hold that Allegheny County is entitled to prepetition interest at a rate of twelve percent per annum under § 5648 and thus **AFFIRM** the ruling of the lower courts on that issue.

B. Postpetition Interest

Turning to the next issue, we note that the parties agree that plaintiffs are entitled to some amount of postpetition interest on their claims, but they disagree as to the rate at which such interest should accrue. In this regard, plaintiffs first argue that the lower courts erred in holding that their claims to postpetition interest at the statutory rates are modifiable under 11 U.S.C. § 1322(b)(2). Alternatively, plaintiffs assert that the confirmed interest rates are insufficient to provide them with the present value of their allowed secured claims under 11 U.S.C. § 1325(a)(5)(B)(ii). We address each of these contentions in turn.

(1) 11 U.S.C. § 1322(b)(2)

Section 1322(b)(2) of the Bankruptcy Code provides that Chapter Thirteen plans may "modify the rights of holders of *secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence.*" 11 U.S.C. § 1322(b)(2) (emphasis added). Defendants concede that plaintiffs' claims are secured by liens on their principal residences. Therefore, the key issue is whether those liens constitute "security interests" for purposes of the antimodification provision of § 1322(b)(2).

The Bankruptcy Code defines "security interest" as "a lien created by an *agreement.*" 11 U.S.C. § 101(51) (emphasis added). In contrast, the Code provides that the term "statutory lien" means a "lien arising *solely by force of a statute* on specified circumstances or conditions . . . but *does not include security interest* or judicial lien." 11 U.S.C. § 101(53) (emphases added). Because plaintiffs' tax liens arose under state statute, and not from a consensual or voluntary agreement with the taxpayer defendants, we concur in the bankruptcy court's ruling that those liens are not "security interests" for purposes of § 1322(b)(2).

The foregoing interpretation of § 1322(b)(2) is supported by substantial authority from other jurisdictions. *See, e.g., In re DeMaggio,* 175 B.R. 144, 146-47 (Bankr. D.N.H. 1994) (holding that plain language and statutory history of § 1322(b)(2) establish that nonconsensual tax liens do not fall within antimodification provision of that statute); *In re Sabec,* 137 B.R. 659, 667-68 (Bankr. W.D. Mich. 1992) (finding antimodification provision of

§ 1322(b)(2) inapplicable because creditor's interest in the principal residence of the debtor was a "lien," rather than a "security interest," based on the fact that it arose non-consensually under state tax act); *In re Venable*, 48 B.R. 853, 856 (S.D.N.Y. 1985) (holding that city's tax lien on debtor's principal residence was modifiable despite § 1322(b)(2) because not consensual, and thus, not a "security interest"); *In re Mitchell*, 39 B.R. 696, 700 (Bankr. D.Or. 1984) (finding IRS lien on debtor's principal residence modifiable because statutory, not created by agreement as required by § 1322(b)(2)); *In re Seel*, 22 B.R. 692, 695-96 (Bankr. D.Kan. 1982) (holding modifiable a mechanic's lien on debtor's principal residence because it was a "statutory lien"). Nevertheless, plaintiffs urge us to hold that statutory tax liens on principal residences are not modifiable under § 1322(b)(2) because Congress has historically made explicit reference to tax liens in provisions of the Bankruptcy Code intended to affect such liens. Plaintiffs further assert that the existence of public policy concerns analogous to those invoked by Congress in exempting liens for unpaid postpetition property taxes from the automatic stay indicates that Congress did not mean for tax liens to be modifiable under § 1322(b)(2). In light of the plain language of § 1322(b)(2), however, we must decline plaintiffs' invitation to speculate as to the intent of Congress in this context. Where the statutory language is clear, our " 'sole function . . . is to enforce it according to its terms.' " *Rake v. Wade*, 508 U.S. 464, 471 (1993) (quoting *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989)).

(2) 11 U.S.C. § 1325(a)(5)(B)(ii)

Our conclusion that plaintiffs' claims are modifiable under § 1322(b)(2) does not dispose of this appeal. We must also determine whether the postpetition interest rate confirmed by the lower courts passes muster under 11 U.S.C. § 1325(a)(5)(B)(ii). In a Chapter 13 bankruptcy, the debtor is given the opportunity to retain property which would otherwise be subject to foreclosure by secured creditors. "In exchange for giving the debtor a right to continue possession of the property, § 1325(a)(5)(B) directs two things: (i) the secured creditor shall retain a continuing lien on the property; and (ii) the secured creditor shall receive from the debtor 'the value, as of the effective date of the plan, of such property to be distributed under the plan on account of such claim [which shall be] not less than the allowed amount of such claim.' " *GMAC v. Jones*, 999 F.2d 63, 66 (3d Cir. 1993) (quoting 11 U.S.C. § 1325(a)(5)(B)(ii)). The latter provision requires that the payments to the secured creditor have a "present value" equal to the creditor's allowed secured claim. 5 COLLIER ON BANKRUPTCY ¶ 1325.06[4][b][iii][B] (15th ed. 1982). Present value is a market rate concept, determined by the use of an interest rate which fairly compensates the creditor for not receiving the full amount of its secured claim upon confirmation of the debtor's plan. There is wide disagreement, however, as to what constitutes an appropriate rate of interest in this context. *See In re Mitchell*, 39 B.R. at 700. Although this court has posited a framework for determining an appropriate interest rate under § 1325(a)(5)(B)(ii) in the context of commercial creditors, neither this court nor the

Supreme Court has addressed that issue in the context of nonconsensual tax lien creditors such as plaintiffs.

In the case at bar, the bankruptcy court began its § 1325(a) analysis with the statutory interest rates, but dismissed them as being in the nature of a penalty. According to the court, the statutory rates were raised by the Pennsylvania Legislature from six percent to their present levels in response to the extremely high commercial interest rates of the late 1970's and early 1980's. In the court's view, the state's purpose in raising the statutory rates was to "coerce and encourage prompt payment of taxes in competition with other higher commercial rates."

Having rejected the statutory rates, the bankruptcy court attempted to determine a more reasonable interest rate, ultimately concluding that the appropriate rate under § 1325(a)(5)(B)(ii) was "the reasonable cost of interest to the [plaintiffs], as of the effective date of the plan, over a 60 month period." Consulting published historical interest rates for municipal bonds, the court determined that, at a minimum, postpetition interest should accrue at 4.05 percent for Allegheny County and 4.30 percent for Penn Hills. Since defendants' plans proposed to pay postpetition interest at seven percent per annum, they were confirmed.

Plaintiffs contend that the bankruptcy court's rejection of the statutory rates was erroneous. In support of their position, plaintiffs rely principally upon our previously cited decision in *Jones*, wherein we addressed the issue of interest rates under § 1325(a) in the context of a commercial creditor. In *Jones*, General Motors Acceptance Corporation ("GMAC") filed secured claims against a

number of Chapter 13 debtors who, prior to taking bankruptcy, had purchased GMC trucks and defaulted on their financing obligations. *Jones*, 999 F.2d at 65. GMAC subsequently objected to the debtors' bankruptcy plans on grounds that the proposed interest rates were too low to provide it with the present value of its claims under § 1325(a)(5)(B)(ii). *Id.* at 66.

Reversing the bankruptcy and district courts, this court held that the interest rate should be determined with reference to the purpose behind § 1325(a)(5)(B)(ii): "to put the secured creditor in an economic position equivalent to the one it would have occupied had it received the allowed secured amount immediately, thus terminating the relationship between the creditor and the debtor." *Id.* at 66-67. The *Jones* court then rejected the bankruptcy court's "cost of funds" approach, which looks to the rate at which the creditor can borrow funds, as falling short of this statutory objective by failing to account for: (1) the cost to the creditor of sustaining its lending relationship with the debtor past the point contemplated in the original agreement; and (2) the expectation of commercial creditors to make a profit when extending credit. *Id.* at 67, 69.

Ultimately, the *Jones* court concluded that a "coerced loan" theory[4] should provide the starting point for determining interest rates under § 1325(a)(5)(B)(ii). *Id.* at 67. Thus, the court held that the appropriate rate of interest is "that which the secured creditor would charge, at the effective date of the plan, for a loan similar in character,[5] amount and duration to the credit which the creditor will be required to extend under the plan." *Id.* at 65 (footnote added). According to the court, this approach, unlike the cost of funds method, closely approximates the creditor's immediate liquidation position because it recognizes that creditors incur costs associated with the coerced extension of credit and because it incorporates a consideration of profit into the determination of the § 1325(a) interest rate.[6] *Id.* at 67-69. The court further found the coerced

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[4] The basic idea behind this theory is that, " 'In effect, the [bankruptcy] law requires the creditor to make a new loan in the amount of the value of the collateral rather than repossess it, and the creditor is entitled to interest on his loan.' " *Jones*, 999 F.2d at 67 (quoting *Memphis Bank & Trust Co. v. Whitman*, 692 F.2d 427, 429 (6th Cir. 1982)).

[5] The court defined loan of "similar character" to mean a "loan that the creditor regularly extends to other debtors who are not in bankruptcy but who are otherwise similarly situated to the debtor who is the recipient of the loan coerced by the chapter 13 proceeding and who are seeking the same kind of credit (*e.g.*, auto loan, home equity loan, etc.)." *Id.* at 67 n. 4.

[6] The court acknowledged that, in making the "coerced" loan, GMAC would not experience all the costs involved in making a completely new extension of credit. *Id.* at 68. However, the court concluded that these savings were offset by the fact that the coerced loans would be more expensive than new loans because they would not contain the "equity cushion" customarily incorporated into new loans. *Id.* Additionally,

loan approach appealing because it would reduce the litigation and transaction costs of Chapter 13 cases due to the fact that "regularly maintained documents of the creditor should make it possible for the debtor and creditor to stipulate on the interest rate the creditor would charge for a new loan of similar character, amount and duration." *Id.* at 70.

Plaintiffs in the case at bar make two arguments based on *Jones*. First, they contend that the plain language of that decision requires that interest in the present case be set to accrue at the rates that they charge nonbankrupt, delinquent taxpayers (*i.e.*, the statutory rates). Second, plaintiffs assert that the bankruptcy court erred in applying a cost of funds approach because that approach was specifically rejected in *Jones*. We agree with plaintiffs that the bankruptcy court's analysis was flawed.

In our view, the district court plainly erred by looking solely to plaintiffs' cost of funds in assessing the appropriateness of the proposed postpetition interest rates in this case. As the Ninth Circuit has noted, such an approach forces a governmental creditor to

> incur an unconditional obligation to repay the money it was required to borrow . . . in exchange [for] only an inherently risky promise by the debtor to repay the same amount over the applicable time period at essentially the same rate paid by the government on its obligation.

GMAC would have increased the rate of interest on a new loan based on the debtor's poor credit history. *Id.*

In re Camino Real Landscape Maint. Contractors, Inc., 818 F.2d 1503, 1506 (9th Cir. 1987) (citation omitted).[7] Thus, the governmental creditor is "worse off as a result of the exchange." *Id.* Moreover, "there is no indication that Congress meant to subsidize debtors by making available to them the government's own favorable rate of interest." *Id.* Thus, we hold that for plaintiffs to be properly compensated, consistent with *Jones*, postpetition interest rates must be set in accordance with the municipalities' costs of maintaining their creditor relationship.

Since municipalities are not for-profit lending institutions and do not regularly extend loans that can be used to determine the appropriate rate of interest, the case at bar is not on all-fours with *Jones*. Nevertheless, we do not believe that *Jones* is totally inapplicable in this situation, despite GMAC's status as a for-profit entity, or that the "cost of funds" approach would be proper if applied to the debtor instead of the creditor. Therefore, the principles of *Jones* must be given effect, even if it is not factually identical.

We believe that the closest analog to the market loan in *Jones* is the statutory interest rate here. While the analogy is not perfect, it is sufficient: an entity forced to delay payment that it is entitled to receive is, in effect, extending a loan. And the rate that the municipality charges for those that coerce loans by not paying their

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[7] Although *Camino Real* involved a present value determination under 11 U.S.C. § 1129(b)(2)(A)(i)(II), the present value language in that section is virtually the same as that employed in § 1325(a)(5)(B)(ii), and most courts have treated the two statutes as identical. *In re DeMaggio*, 175 B.R. at 150.

property tax bills is twelve percent. In fact, as the difficulties in arriving at another rate have shown, the statutory rate is really the only practical and reasonable rate to apply. The statutory rate also serves the administrative efficiency goal of establishing a readily ascertainable "market" rate that will not require the time and expense of case-by-case litigation and potentially inconsistent results.

Political and financial market forces will generally operate to keep the statutory rate reasonable. The rate is set by elected officials accountable to citizens who, after all, must balance their desire to make their neighbors pay their property taxes with the consideration that they themselves may be in default some day. In addition, the financial market might provide the best check against oppressive rates. If a debtor can, in fact, do better than the statutory rate, he or she will rationally do what consumers normally do when rates (for instance, mortgage notes) become higher than the market. The debtor will "refinance" by obtaining the new loan at the lower available rate, using the funds to pay off the old loan. Indeed, the statutory rate at issue in this case – twelve percent – is not unreasonable. Credit card companies regularly charge their customers, who are not even high credit risks, interest at rates as high as eighteen percent. The debtors in this case, of course, are in bankruptcy and, although the municipality currently holds liens that are oversecured, property values can decline.

In support of our holding, we note that numerous courts have held that nonconsensual oversecured creditors are entitled to receive the rates of interest dictated by the statutes under which their liens arose, unless those

rates constitute a penalty. *See, e.g., Galveston Ind. Sch. Dist. v. Heartland Fed. Sav. & Loan Ass'n,* 159 B.R. 198, 204 (Bankr. S.D. Tex. 1993); *see also In re Parr Meadows Racing Ass'n,* 880 F.2d 1540, 1549 (2d Cir. 1989), *cert. denied sub nom., Suffolk County Treasurer v. Barr,* 493 U.S. 1058 (1990). Although the bankruptcy court initially determined that the statutory rates at issue in this appeal are in the nature of a penalty, we find this decision to be in error. *See Meilink v. Unemployment Reserves Commission,* 314 U.S. 564 (1942). In *Meilink,* a unanimous Supreme Court held that a statutorily imposed interest rate of twelve percent on debts owed to a state's unemployment fund did not constitute a penalty within the meaning of the Bankruptcy Code. In that regard, the Court stated:

> It is common knowledge that interest rates vary not only according to the general use value of money but also according to the hazard of particular classes of loans. Delinquent taxpayers as a class are a poor credit risk; tax default, unless an incident of legitimate tax litigation, is, to the eye sensitive to credit indications, a signal of distress. A rate of interest on tax delinquencies which is low in comparison to the taxpayer's borrowing rate – if he can borrow at all – is a temptation to use the state as a convenient, if involuntary, banker by the simple practice of deferring the payment of taxes.
>
> Another variable is the amount necessary to compensate for the trouble of handling the item. The legislature may include compensation to the state for the increased costs of administration in

> the exaction for delay in paying taxes without thereby changing it from interest to penalty.

Id. at 567.[8]

We believe that Judge Sarokin's arguments for using the prime rate prove too much. If the prime rate represents the appropriate rate in the commercial marketplace, why did not the *Jones* court use the prime rate in that case, which, after all, involved a commercial lender?

Moreover, that the Pennsylvania legislature has not seen fit to change the statutory rate on delinquent tax loans for some years, in our view, does not render the twelve percent rate penal or unreasonable. *If* the statutory rate, as suggested by the dissent, "far exceed[s] what the Plaintiffs could obtain under current market conditions," then the debtors (or the bankruptcy trustee) can proceed to obtain the more favorable rate in the market.

VI. CONCLUSION

Based on the foregoing, we **AFFIRM** the district court's award of prepetition interest to Penn Hills and Allegheny County at the statutory rates of ten and twelve percent per annum, respectively. We **REVERSE**, however, the decisions of the bankruptcy court and district court on the issue of postpetition interest rates and hold that

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[8] We also note the Supreme Court's recent decision in *Rake v. Wade*, 508 U.S. 464 (1993), in which the Court provided for broad postpetition interest in a Chapter Thirteen situation for the benefit of an oversecured mortgage holder despite the fact that the instrument itself was silent on arrearages.

Penn Hills and Allegheny County are also entitled to postpetition interest at the respective statutory rates.

SAROKIN, *Circuit Judge*, concurring in part and dissenting in part:

I join Parts I, II, III, IV, V.A, and V.B.(1) of the Majority's opinion. However, because I do not believe that the statutory rate should apply to postpetition interest, I dissent from the Majority's analysis and conclusion in Part V.B.(2).

I agree with the Majority that the "cost of funds" approach adopted by the bankruptcy court is flawed because it under-compensates the municipality and it offers the debtors a windfall by enabling them, in effect, to borrow funds from the municipality at rates that are generally available only to state entities.

But because I do not agree with the Majority's reliance on *General Motors Acceptance Corp. v. Jones*, 999 F.2d 63, 67 (3d Cir. 1993), I would reject as well the Plaintiffs' suggestion that we apply the statutory rate to post-petition interest payments. The situation here differs from that in *Jones* in one important way: in *Jones*, the creditor was a commercial lender, in the business of lending money to earn a profit. Unlike the Majority, *see* Majority Op. at 10, I believe that this difference is significant.

I. *The statutory rate*

In a market that is subject to the rigors and constraints of competition, the interest rate charged by a commercial lender (Lender A) should reflect the approximate cost of capital plus transaction costs, and a small

profit component. If interest is set at a rate that substantially exceeds Lender A's costs in order to yield greater profits, competitors should be able to lure borrowers away from Lender A by setting their rates below that charged by Lender A while still earning a profit. Ultimately, the more competitive the market, the more closely the rate will reflect the costs incurred by the lender. Therefore, setting post-petition interest at a rate equal to the rate charged by a creditor-lender in the commercial market should come closest to compensating that creditor both for the non-availability of its capital and for the costs of maintaining the relationship, and should therefore "put the secured creditor in an economic position equivalent to the one it would have occupied had it received the allowed secured amount immediately, thus terminating the relationship between the creditor and the donor." *Jones*, 999 F.2d at 66-67.

Here, the creditors are governmental entities. The interest rates that they can charge "debtors" – i.e., those who have defaulted on their tax payments – are not constrained by competitive considerations, but imposed by statute. These rates were set at their current level in the early 1980s, and have not been modified since. "Courts are generally in agreement that an interest rate to compute present value must be responsive to current economic conditions" and "that an unchanging fixed rate established at some prior time is not appropriate in a present value analysis." *In re DeMaggio*, 175 B.R. 144, 150-51 (Bankr. N.H. 1994). It is easy to understand why: market rates have dropped significantly since the early 1980s. The statutory rates have not followed the commercial market's downward path and as a result "ha[ve] no

relation to current economic conditions." *Id.* at 151. In fact, they far exceed what the Plaintiffs could obtain under current market conditions. Because they are so high, the statutory rates now "include a punitive element that is contrary to the purposes of the Bankruptcy Code" and "inimical to financial rehabilitation of the debtor." *In re Camino Real Landscape Maintenance Contractors, Inc.*, 818 F.2d 1503, 1507 n. 2 (9th Cir. 1987). *See also In re DeMaggio*, 175 B.R. at 151 (noting that "[i]nterest rates on delinquent taxes frequently incorporate a punitive aspect to discourage nonpayment.").[1]

Because statutory rates are not subject to the discipline of the market, and because considerations of deterrence may in fact warrant a rate of interest for tax evasion that far exceeds costs, there is no reason to expect that the statutory rates are calculated to compensate the Plaintiffs for the present value of their claims, and to serve the objective of section 1325(a)(5)(B)(ii), which is "to put the creditor in the same position it would have been in if it had been allowed to end the lending relationship at the point of the bankruptcy filing by repossessing the collateral." *Jones*, 999 F.2d at 69. Therefore, I reject the approach recommended by the Plaintiffs and espoused by the Majority, and would not set the postpetition interest rate at the statutory rate.[2]

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[1] The Majority cites a 1942 Supreme Court case, *Meilink v. Unemployment Reserves Commission*, 314 U.S. 564 (1942), to suggest otherwise. *Meilink*, however, did not involve a secured debtor, *see id.* at 567 (describing taxpayers as "a poor credit risk"), and is therefore clearly not applicable to the facts of this case.

[2] The Plaintiffs cite three cases in support of their argument that we should adopt the statutory rate as the

II. *The prime rate*

I would hold, instead, that the appropriate rate to compute the present value of a claim by an oversecured government creditor pursuant to section 1325(a)(5)(B)(ii) is the rate charged by commercial banks to prime commercial loan customers – that is, the prime rate – for a loan of equivalent amount and duration. This method has been adopted by other courts, *see, e.g., In re Jordan,* 130 B.R. 185, 191 (D.N.J. 1991); *In re Hudock,* 124 B.R. 532, 534 (N.D. Ill. 1991), and it addresses most of the concerns raised by alternative methods.

First, because it imposes a rate higher than the municipal bond rate, it offers the Plaintiffs a measure of compensation for the various costs, beyond the costs of capital, incurred in the delayed collection of tax payments.

Second, because it is based on a market rate, it is sensitive to changes in the costs of borrowing in the larger economy, and derivatively to the costs of borrowing for municipal governments as well. "Market rates are the best indicators of the present value of deferred payments because they are products of supply and demand,

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appropriate rate: *In re Camino Real Landscape Maintenance Contractors, Inc., supra; United States v. Neal Pharmacal Co.,* 789 F.2d 1283 (8th Cir. 1986); *Matter of Southern States Motor Inns, Inc.,* 709 F.2d 647 (11th Cir. 1983). Clm. Brf. at 31-33. Ironically, however, these three cases all adopted a "present market value" approach. To the extent that they did refer to the statutory rate, the rate they referred to was a federal rate calculated on a biennial basis to account for changes in interest rates in the market, not a rate left unchanged for over ten years.

reflecting the interactions of economic variables that affect the cost of lending money." *In re Ivey*, 131 B.R. 43, 49 (Bankr. N.C. 1991).

Third, because it is divorced from the statutory rate, it does not include a punitive element that is inimical to the purposes of bankruptcy reorganization.

Fourth, it is a readily available figure, and therefore relatively easy to compute.

Fifth, it does not create any incentives for debtors to delay payment of their real property taxes, since they would incur little benefit from such a delay.

I note that the Plaintiffs had urged that we consider a variation of this approach if we rejected the statutory rate. Specifically, they had urged that we adopt the prevailing commercial market rate, but taking into account factors such as the term of the payout period, the value of security and the risk of default, the statutory rate of interest, and the characteristics of the debtor in each case. Clm. Brf. at 34. Several circuits have adopted this measure of present value for debt owed to government, albeit in the context of a Chapter 11 bankruptcy. *See, e.g., In re Camino Real Landscape Maintenance Contractors, Inc.*, 818 F.2d at 1504 (holding that "the debtor must pay the government interest at the rate the debtor would pay a commercial lender for a loan of equivalent amount and duration, considering the risk of default and any security"); *United States v. Neal Pharmacal Co.*, 789 F.2d 1283, 1289 (8th Cir. 1986); *In re Southern States Motor Inns, Inc.*, 709 F.2d 647, 652-53 (11th Cir. 1983) (same). Under this more refined approach, "the bankruptcy court must make

a case-by-case determination of what interest the reorganizing debtor would have to pay a creditor in order to obtain a loan on equivalent terms in the open market." *In re Camino Real Landscape Maintenance Contractors, Inc.*, 818 F.2d at 1508.

The approach urged upon us by the Plaintiffs is unnecessarily unwieldy, and therefore I would reject it. All three cases cited by the Plaintiffs dealt with the proper method for determining the rate of interest to be applied in calculating deferred payments of delinquent federal taxes pursuant to 11 U.S.C. § 1129(a)(9)(C). However, section 1129(a)(9)(C) applies only to *unsecured* claims. Therefore, the risk of default on such debt is substantial. The risk present in the instant case is much less significant. As the DeSarnos note, the County and School District "are *at very low risk of not receiving payment while enjoying a correspondingly high quality of security in the event of default under the Plan.* The taxing bodies both enjoy priority status as creditors of the Debtors and are first in line to receive the amounts owed due to their position of possessing a statutory lien upon the Debtors' residence." DeSarno Brief at 24. Therefore, it is not necessary to refine our approach to account for the particular characteristics of each debtor.

I recognize that the prime rate approach, which reflects transactions between commercial lenders and borrowers, is not a perfect fit for government creditors. As noted *supra*, the costs of borrowing for a municipal government and for a commercial lender are not identical, both with regard to their "replacement costs" – i.e., the rate at which they can borrow funds – and "transaction costs." In addition, the market rate reflects the profit

margin that motivates commercial lenders in the first place, but that is not a consideration for municipalities.

While the commercial market rate of interest for a low-risk, secured loan is not a perfectly accurate measure, exactitude is not the only consideration – judicial economy and efficiency are also important factors, especially in matters involving high volume and relatively low amounts. Numerous courts, including this one, have recognized "the importance of minimizing the expense of getting a chapter 13 plan formulated and approved," *Jones*, 999 F.2d at 70, and therefore devising a formula that is relatively easy to compute. I believe that the approach I suggest here strikes the best balance between these two priorities and satisfactorily addresses our various other concerns as well.[3]

A True Copy:
Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

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[3] Furthermore, to the extent that the prime rate, like the municipal bond rates, is easily ascertainable from financial publications, I would agree with the district court that the bankruptcy court could take judicial notice of the applicable rate, and that it would need not hold hearings now to determine what that rate is.

COUNTY OF ALLEGHENY;
PENN HILLS SCHOOL DISTRICT,

Appellants,

v.

SAMUEL M. DESARNO; ALICE DESARNO
GARY J. GAERTNER, ESQUIRE,

Trustee.

On appeal from the United States District Court
for the Western District of Pennsylvania
(Civil Action Nos. 94-982 and 94-1174)

Present: Becker, Sarokin and Wellford,* *Circuit Judges*

JUDGMENT

These causes came on to be heard on the record from the United States District Court for the Western District of Pennsylvania and were argued by counsel on November 20, 1995.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court entered on December 6, 1994, be, and the same is hereby affirmed in part and reversed in part in accordance with the opinion of this Court.

*** Honorable Harry W. Wellford, United States Court of Appeals for the Sixth Circuit, Sitting by Designation.**

ATTEST:

/s/ Patricia A. Coleman
Legal Coordinator

Dated: July 30, 1996

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

LAURA RANKIN, DAVID RANKIN, STACY JOHNSON and ALICE BONACCI,	)	
Appellants,	)	
vs.	)	Civil Action No. 94-982
SAMUEL M. DESARNO and ALICE DESARNO,	)	
Appellees,	)	
COUNTY OF ALLEGHENY and PENN HILLS SCHOOL DISTRICT,	)	
Respondents.	)	
COUNTY OF ALLEGHENY and PENN HILLS SCHOOL DISTRICT,	)	
Appellants,	)	
vs.	)	Civil Action No. 94-1174
SAMUEL M. DESARNO and ALICE DESARNO,	)	
Appellees.	)	

MEMORANDUM OPINION

December 6, 1994

Before the Court is the appeal of the County of Allegheny and the Penn Hills School District and the cross-appeal of Laura and David Rankin, Stacy Johnson and Alice Bonacci, from the order of the Bankruptcy Court

dated May 13, 1994, which provided that (i) the debtors, Samuel and Alice Desarno ("Desarnos"), Laura Rankin, David Rankin, Stacy Johnson and Alice Bonacci shall pay Allegheny County pre-petition interest in the amount of 12% on its secured claim; (ii) the debtors shall pay the Municipality of Penn Hills and the School District of Penn Hills pre-petition interest in the amount of 10% on its secured claims; (iii) that the debtors may properly modify the post-petition claims of Allegheny County, the Municipality of Penn Hills and the School District of Penn Hills ("Claimants"); and (iv) the debtors may pay the claimants' post-petition interest in the amount of 7% as proposed in their Chapter 13 plan.

The cases of the various debtors were consolidated in the Bankruptcy Court for resolution of certain common issues, including whether a municipality is entitled to receive the statutory rate of interest on its secured claim and if not, what rate of interest should be permitted.

On appeal, the County of Allegheny and Penn Hills School District raised, *inter alia*, the following issues: (i) whether the Bankruptcy Court erred in determining that the State's statutory rate of interest due post-petition on an oversecured statutory real estate tax lien is modifiable; (ii) if the post-petition State interest rate is modifiable, whether the Bankruptcy Court applied the correct criteria in determining the proper modified post-petition interest rate; (iii) whether the Bankruptcy Court erred in not granting an evidentiary hearing to determine the proper rate of interest due post-petition on an oversecured statutory real estate tax lien credit; and (iv) whether the Bankruptcy Court erred in finding and in taking judicial notice of certain facts which were not of record or which had not

otherwise been offered into evidence by any of the parties.

In their cross-appeal, the Rankins, Johnson and Bonacci raise the issue of whether Allegheny County is permitted to impose 12% rather than 10% pre-petition interest on delinquent taxes.

Legal Discussion

On appeal from an order of the Bankruptcy Court, the District Court must apply the clearly erroneous test to factual findings and plenary review to questions of law.

Moreover, mixed questions of law and fact must be divided into the respective components and the appropriate test applied. *In Re: Brown*, 951 F.2d 564 (3d Cir. 1991).

After careful consideration of the memoranda of law and the arguments of the parties, this Court finds that the Bankruptcy Court's findings of fact are not clearly erroneous and that the Bankruptcy Court did not err with regard to the applicable questions of law. Simply stated, the Court finds the Bankruptcy Court's opinion to be well-reasoned, its findings were not erroneous and that it contains a correct statement of the law.

Initially, the Court was concerned whether the Bankruptcy Court erred in not granting an evidentiary hearing to determine the proper rate of interest due post-petition to the claimants, and whether the Court erred in finding and in taking judicial notice of certain facts which were not of record or which had not otherwise been offered into evidence by any of the parties.

However, upon reflection in that regard, the Court concludes that the Bankruptcy Court's analysis of the law and its taking judicial notice of the appropriate interest rates was correct. *Cf. Transorient Navigators' Co. S.A. v. M/S Southwind,* 788 F.2d 288 (5th Cir. 1986) (district court may properly take judicial notice of prevailing interest rates); *Harris Trust and Savings Bank v. John Hancock Mutual Life Ins. Co.,* 767 F.Supp. 1269 (S.D.N.Y. 1991) (court may take judicial notice of high interest rates prevailing in the late 1970's and early 1980's over those in previous years); *George's Radio and T.V. v. Ins. Co. of North America,* 536 F.Supp. 681 (1982) (no testimony presented concerning market rates of return. However, court may take judicial notice pursuant to Fed.R. Evidence 201 at any stage of a proceeding even though not requested to do so).

Therefore, an appropriate order dismissing the appeals will be entered.

Lee, Jr.

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

LAURA RANKIN, DAVID RANKIN, STACY JOHNSON and ALICE BONACCI, Appellants, vs. SAMUEL M. DESARNO and ALICE DESARNO, Appellees, COUNTY OF ALLEGHENY and PENN HILLS SCHOOL DISTRICT, Respondents.	)	Civil Action No. 94-982
COUNTY OF ALLEGHENY and PENN HILLS SCHOOL DISTRICT, Appellants, vs. SAMUEL M. DESARNO and ALICE DESARNO, Appellees.	)	Civil Action No. 94-1174

ORDER OF COURT

AND NOW, this 6th day of December, 1994, after hearing, it is hereby

ORDERED that the appeals of Laura and David Rankin, Stacy Johnson, Alice Bonacci, the County of Allegheny and Penn Hills School District are **DISMISSED.**

/s/ Donald J. Lee
Donald J. Lee
United States
District Judge

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Clerk, U.S. Bankruptcy Court

IN THE UNITED STATES BANKRUPTCY COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA

IN RE:	)	
SAMUEL AND ALICE DESARNO,	)	Case No. 93-22234 JLC
Debtors/Movants,	)	Chapter 13
vs.	)	
COUNTY OF ALLEGHENY,	)	
Respondent.	)	

MEMORANDUM OPINION

The issue before the court is whether a Chapter 13 debtor can modify the postpetition interest rate claimed by an oversecured statutory lien creditor without violating 11 U.S.C. §§ 1322(b)(2), 1325(a)(5)(B)(ii) and 506(b). After careful consideration, the issue is determined in the affirmative.

I. FACTS

Samuel and Alice DeSarno ("Debtors") defaulted on their real estate taxes owed to Allegheny County, the Penn Hills Municipality and the Penn Hills School District (hereinafter referred to collectively as the "Claimants"). In order to avoid foreclosure, the Debtors filed a voluntary petition under Chapter 13 of the Bankruptcy Code on June 25, 1993. On July 13, 1993, the Debtors filed a Chapter 13 plan that proposes to pay 100% of the principal outstanding taxes due to the Claimants, in addition to all prepetition interest claimed. The Debtors'

Chapter 13 plan also proposes to pay 100% of the Claimants' postpetition principal claim; however, the plan modifies the Claimants' claims by proposing to pay a reduced postpetition interest rate amount.[1]

On September 16, 1993, an order was entered confirming the Chapter 13 amended plan subject to the resolution of these tax claims. On November 17, 1993, the plan was confirmed subject to *inter alia*, the resolution of the amount of postpetition interest due the Claimants. At the confirmation hearing, the Claimants objected to their postpetition treatment alleging that they were entitled to receive 12% and 10% interest on their claims pursuant to the Pennsylvania Municipal Code. The Debtors objected and argue that 11 U.S.C. § 1322(b)(2) permits the Claimants' claims to be modified and further, that the Claimants should only be paid a "reasonable" interest rate rather than the statutory rates.

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[1] The Debtors do not dispute that they owe the Claimants the following amounts in taxes:

1)	*Allegheny County*:	$ 521.19	prepetition
		$1,140.04	postpetition
2)	*Penn Hills Municipality*:	$ 687.99	postpetition
3)	*Penn Hills School District*:	$1,435.24	prepetition
		& [sic] 1,548.10	postpetition

II. DISCUSSION

A. Prepetition Interest

Generally in bankruptcy, interest on prepetition claims stops accruing as of the bankruptcy filing. 11 U.S.C. § 502(b)(2). The Debtors concede that the Claimants are entitled to prepetition interest at the statutory rate, and they propose in their Chapter 13 plan to make 100% payment of the Claimants' prepetition claims, both principal and interest.

Pursuant to 72 Pa.C.S.A. § 5648, Allegheny County, as a second class county in the Commonwealth of Pennsylvania,[2] may claim interest on all delinquent taxes "at a rate determined by the county commissioners not to exceed twelve per centum per annum until paid, . . . " 72 Pa.C.S.A. § 5648 (Purdon's 1990). Therefore, a legislative cap exists so that Allegheny County cannot charge its residents more that [sic] 12% for unpaid taxes. This also means that Allegheny County has the authority to charge something *less* than 12%; however, the County Commissioners in their discretion have chosen to charge the maximum amount.

Title 53 Pa.C.S.A. § 7143 dictates that interest claims made by municipalities for unpaid taxes cannot exceed ten percent per annum. 53 Pa.C.S.A. § 7143 (Purdon's 1972). Therefore, the municipality of Penn Hills and its

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[2] The counties in Pennsylvania are divided into 9 separate classes, each classification being based upon the population of the county. 16 Pa.S.C.A. § 3210. Allegheny County is classified as a second class county. *Id.*

school district may charge their delinquent tax payers a maximum of 10% interest for unpaid taxes.

Neighborhood Legal Services Association ("NLSA") filed a brief in the instant case which asserts that these two statutory provisions "clash." Specifically, NLSA argues that because 72 Pa.C.S.A. § 5648 and 53 Pa.C.S.A. § 7143 maintain different statutory interest rate guidelines, they conflict, and that the language of 53 Pa.C.S.A. § 7143 preempts 72 Pa.C.S.A. § 5648. Consequently, NLSA argues that Allegheny County could only charge the Debtors a maximum of 10% interest, and not 12%.

The language NLSA points to in support of its argument is as follows:

> Where the provisions of *any other act* relating to claims for taxes . . . utilizes the procedures provided in *this act* and where the provisions of *such other act* establishes a different rate of interest for such claims or liens the maximum rate of interest of ten percent per annum as provided for in this section shall be applicable to the claims and liens provided for under such acts. . . . (emphasis added)

53 Pa.C.S.A § 7143.

This language attempts to reconcile the various interest rates established within the same *act*, which in this case is the Municipal Claims Act of 1923, as amended 1981. Section 5648 is not within this same act. In fact, 72 Pa.C.S.A. § 5648 is in an entirely different title of the Pennsylvania Code. Furthermore, 72 Pa.C.S.A. § 5648 specifically states in its title that it applies to counties of the second class in the Commonwealth of Pennsylvania, of which Allegheny County is the only county.

In addition, municipal and school taxes are different than county taxes, serving different purposes and providing different services as well as sources of funding. Therefore, NLSA's argument that 53 Pa.C.S.A. § 7143 and 72 Pa.C.S.A. § 5648 conflict is without merit. A state court is welcome to address this issue. For this case, the court finds that Allegheny County has the authority under the state statute to charge its residents interest for unpaid taxes in an amount not to exceed 12%. Below, this court will address whether a debtor can modify this interest rate in a Chapter 13 plan.

B. Postpetition Interest

Although interest on prepetition claims generally stops accruing as of the bankruptcy filing, 11 U.S.C. § 502(b)(2), there is an exception in the Bankruptcy Code when the value of the collateral is sufficient to satisfy both principal and interest due on a claim. 11 U.S.C. § 506(b). Section 506(b) states as follows:

> To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which the claim arose.

11 U.S.C. § 506(b).

Section 506(b) authorizes the payment of postpetition interest to oversecured creditors. In *U.S. v. Ron Pair*, 489 U.S. 233 (1989), the United States Supreme Court held

that 11 U.S.C. § 506(b) authorizes payment of postpetition interest on *nonconsensual* oversecured prepetition claims.[3] In general, the interest allowed by § 506(b) will accrue until payment of the secured claim or until the effective date of the plan. 3 Collier on Bankruptcy ¶ 506.05, p. 506-43 (15th ed. 1993). In *Rake v. Wade*, ___ U.S. ___, 113 S.Ct. 2187, 2190 (1993), the Supreme Court held that 11 U.S.C. § 1325(a)(5)(B)(ii) further entitles oversecured creditors to post confirmation interest.

In the instant case, all three Claimants are oversecured statutory (nonconsensual) lien creditors. Therefore, based on *Ron Pair* and *Rake v. Wade*, the Claimants are entitled to pre and post confirmation interest on their respective claims. However, although the Claimants are entitled to interest, the court must determine whether the Claimants are entitled to the statutory rate of interest, or if the Debtors may reduce the claimed interest rates in their Chapter 13 plan, thereby modifying the claims. Put another way, if the Debtors reduce the Claimants' postpetition interest claims, the court must determine whether such a modification violates 11 U.S.C. § 1322(b)(2). If the Debtors can modify the Claimants' claim for interest without violating § 1322(b)(2), the court must then decide what rate of interest is appropriate.

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[3] In *Ron Pair*, the Supreme Court held that the United States was entitled to postpetition interest on its nonconsensual tax liens for unpaid withholding and social security taxes. *Id.* at 237-38. *See also Rake v. Wade*, ___ U.S. ___, 113 S.Ct. 2187 (1993).

1. Modification Pursuant to § 1322(b)(2)

Under the Bankruptcy Code, a Chapter 13 plan may modify the rights of a secured claimant, but the plan may not do so if the creditor's claim is secured only by a security interest in real property that is the debtor's principal residence. 11 U.S.C. § 1322(b)(2). This principal has been confirmed by the courts, most notably by the U.S. Supreme Court in *Nobelman vs. American Savings Bank*, ___ U.S. ___, 113 S.Ct. 2106, 124 L.Ed.2d 228 (1993). Section § 1322(b)(2) states as follows:

> **(b)** Subject to subsections (a) and (c) of this section, the plan may –
>
> **(2)** modify the rights of holders of *secured claims*, other than a claim only by a *security interest* in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims; (emphasis added)

11 U.S.C. § 1322(b)(2).

The task of resolving the dispute over the meaning of § 1322(b)(2) begins with the language of the statute itself. Section 1322(b)(2) uses both terms "secured claims" and "secured interest" in two different, yet adjacent, places. By definition, "secured interests" are those created by an agreement between the parties; thus making them voluntary or consensual. 11 U.S.C. § 101(51). The term "secured claims" is not defined in the Bankruptcy Code, but "claims" is defined by itself as meaning the right to payment, whether secured or unsecured. 11 U.S.C. § 101(5)(A); *See Ron Pair, supra* at 238-39.

Secured claims are therefore claims that have been perfected in some fashion, either by virtue of a secured interest, a statute, or a judgment. Statutory claims are considered to be nonconsensual because they are created and fixed by operation of law. 11 U.S.C. § 101(53). The term "statutory lien" is defined in the Bankruptcy Code as a "lien arising solely by force of a statute . . . *but does not include security interest* or judicial lien . . . " *Id.*

The Claimants in this case possess claims, or rights to payment, which are secured against the Debtors' principal residence by virtue of statutory liens. Based on the language of § 1322(b)(2) and the definitions of "security interest," "claim" and "statutory lien," it is determined that for the purposes of § 1322(b)(2), the Claimants' secured claims can be modified by the Debtors' Chapter 13 plan because they do not possess security interests in the Debtors' real property. The Claimants possess liens that create secured claims against the property, not security interests, and such claims are not protected by § 1322(b)(2).

This statutory construction of 11 U.S.C. § 1322(b)(2) has judicial support: *In re Venable*, 48 B.R. 853, 856 (S.D.N.Y. 1985); *In re Mitchell*, 39 B.R. 696, 700 (Bankr.D. Oregon 1984); *In re Seel*, 22 B.R. 692, 695-96 (Bankr.D.Ka. 1982); *In re Crotty*, 11 B.R. 507, 510 (Bankr.N.D.Tx. 1981). Therefore, for the reasons stated above, this court holds that the Claimants' secured claims are not protected from modification by 11 U.S.C. § 1322(b)(2).

2. What Rate of Interest is Reasonable

Although the Debtors may properly modify the Claimants' oversecured secured claims under 11 U.S.C. § 1322(b)(2), this does not mean that the Debtors may reduce the Claimants' right to postpetition interest down to 0%. Section 1322(b)(2) does not operate to the exclusion of the other sections within Chapter 13. The court must consider the application of 11 U.S.C. § 1325(a)(5)(B)(ii) to decide what interest rate is appropriate under these circumstances. Section 1325(a)(5)(B) states as follows:

> **(a)** Except as provided in subsection (b), the court shall confirm a plan if –
>
> > **(5)** with respect to each allowed secured claim provided for by the plan –
> >
> > **(B)(i)** the plan provides that the holder of such claim retain the lien securing such claim; and
> >
> > **(ii)** the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim;

11 U.S.C. § 1325(a)(5)(B).

Therefore, pursuant to § 1325(a)(5)(B) a Chapter 13 plan may be confirmed over the objection of a secured creditor if certain conditions met. Specifically, a debtor may retain property in which a secured creditor has a security interest, even if the secured creditor would prefer to repossess and liquidate the property as it would be entitled to do outside of bankruptcy. In exchange for giving the debtor a right to continue possession of the

property, § 1325(a)(5)(B) directs two things: i) that the secured creditor retain a continuing lien on the property; and ii) that the secured creditor must be paid "the value, as of the effective date of the plan," which shall be "not less than the allowed amount of such claim." 11 U.S.C. §§ 1325(a)(5)(B).

In the recent Supreme Court decision of *Rake v. Wade*, the Court addressed the issue of whether oversecured creditors were entitled to post confirmation interest. *Rake v. Wade, supra* at 2190. In an effort to reconcile §§ 506(b) and 1325(a)(5)(B)(ii), the Court stated in part:

> [T]hus, unless the creditor accepts the plan or the debtor surrenders the collateral to the creditor, 1325(a)(5)(B)(ii) guarantees that property distributed under a plan on account of a claim, including deferred cash payments and satisfaction of the claim . . . must equal the present dollar value of such claim as of the confirmation date.

Id. at 2191.

The Supreme Court concluded that under 11 U.S.C. § 1325(a)(5)(B)(ii), an oversecured creditor is entitled to the "present value" of its post confirmation claim as an element of an allowed secured claim provided for by the plan. *Id.* at 2193. Unfortunately, neither the Bankruptcy Code nor the Supreme Court offer guidance as to *how* to determine present value.[4]

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[4] Other courts have defined "present value" for the purposes of 11 U.S.C. § 1129: *In re Camino Real Landscape Maint. Contractors*, 818 F.2d 1503, 1505 (9th Cir. 1987); *In re Welco Industries, Inc.*, 60 B.R. 880, 882 (9th Cir.BAP 1986); *In re General*

In *GMAC v. Jones*, 999 F.2d 63 (3d Cir. 1993), the Court of Appeals for the Third Circuit recently defined "present value" for the purposes of 11 U.S.C. § 1325(a)(5)(B). In *GMAC v. Jones*, GMAC objected to the interest rate provided for its claim under the debtor's Chapter 13 plan, contending that the proposed interest rate was too low to provide it with the present value of its allowed secured claim over the time of the plan, as required by 11 U.S.C. § 1352(a)(5)(B)(ii).

The Third Circuit considered two theories for determining present value and decided that the "coerced loan" theory was the most appropriate under the circumstances of a Chapter 13 cramdown.[5] Under the "coerced loan" theory, the Third Circuit held that the rate of interest under 11 U.S.C. § 1325(a)(5)(B)(ii) is "[t]hat which the secured creditor would charge, at the effective date of the plan, for a loan similar in character, amount, and duration to the credit which the creditor will be required to extend under the plan." *Id.* at 70. The court's definition of

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Development Corp., 135 B.R. 1008, 1011-12 (Bankr.S.D.Fla. 1991); *In re Busone*, 71 B.R. 201, 204 (Bankr.E.D.N.Y. 1987); *In re Roxbury Residential Assoc., Inc.*, 35 B.R. 348, 349 (Bankr.D.Conn. 1983); *In re Connecticut Aerosols, Inc.*, 31 B.R. 883, 886 (Bankr.D.Conn. 1983). *See also* 5 *Collier on Bankruptcy*, ¶ 1129.03 at 1129-98 to 1129-103.

[5] Other appellate courts have also considered and applied the "coerced loan" theory to create an interest rate equal to "similar loans": *United Carolina Bank v. Hall*, 993 F.2d 1126 (4th Cir. 1993); *In re Hardzog*, 901 F.2d 858 (10th Cir. 1990); *United States v. Arnold*, 878 F.2d 925 (6th Cir. 1989); *United States v. Neal Pharmacal Co.*, 789 F.2d 1283 (8th Cir. 1986); *Matter of Southern States Motor Inns, Inc.*, 709 F.2d 647 (11th Cir. 1983), *cert. denied*, 465 U.S. 1022 (1984).

"a loan of similar character," was a "loan that the creditor regularly extends to other debtors who are not in bankruptcy but who are otherwise similarly situated to the debtor who is the recipient of the loan coerced by the chapter 13 proceeding and who are seeking the same kind of credit (e.g., auto loan, home equity loan, etc.)." *Id.* at 67, n.4.

The Third Circuit reasoned that "[a]ny creditor extending credit anticipates that over the course of the loan it will recover, in interest, its cost of capital and its cost of service, as well as profit." *Id.; accord, Memphis Bank & Trust Co. v. Whitman*, 692 F.2d 427 (6th Cir. 1982). The court also believed that the "coerced loan" theory was most appropriate because it is based upon the statutory objective of 11 U.S.C. § 1325(a)(5)(B)(ii), which is "to put the secured creditor in an economic position equivalent to the one it would have occupied had it received the allowed secured amount immediately. . . . " *Id.* at 65.

Finally, in *GMAC v. Jones*, the Third Circuit considered other elements of a "coerced loan" such as profit and risk. The court concluded that although a "coerced loan" may result in an interest rate that includes an element of profit, "it would be inappropriate to attempt to exclude consideration of 'profit' from a determination of the § 1325 interest rate." *Id.* at 69. In addition, the court considered the practice of gauging a lending rate based upon a debtor's credit history and whether an "equity cushion" may exist in the collateral when determining present value. The court suggested that the bankruptcy process itself counter-balanced these factors so as to create the best approximation for courts to rely upon. *Id.* at 68-69. The court explained as follows:

> Nevertheless, we are persuaded that the elements that would tend to make "coerced loans" more costly to the secured creditor than new loans, and the elements that would tend to make "coerced loans" less costly to the secured creditor than new loans will generally balance out and that it would be difficult or impossible to empirically demonstrate and quantify the cost differential between new and coerced loans.

In the instant case, the statutory interest rates of 12% charged by Allegheny County and 10% charged by Penn Hills, are rates that were authorized by the Pennsylvania legislature in the late 1970's and early 1980's, a different economic period regarding interest rates than exists today.[6] At the time these higher interest rates were permitted by the legislature, the market rates for commercial interest had risen to record levels.

As a result of these high rates, tax collections became impaired because some taxpayers paid other creditors and allowed their tax bills to accumulate at the lower 6% statutory rate. In the early 1980's, a 6% interest rate was a very favorable rate to a taxpayer. Therefore, the 1981-82 amendments made by the Pennsylvania legislature were designed coerce and encourage prompt payment of taxes in competition with other higher commercial rates. However, in the last 10 years commercial market interest rates have declined to a historical low. Consequently, these

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[6] Allegheny County's legislative history (72 P.S. § 5645): P.L.372, No.106, May 5, 1982, amending the act of May 31, 1933 (P.L.1135, No.280); and municipal tax collection legislative history (53 P.S. § 7143): P.L.319, No.113, Oct. 29, 1981, amending the act of May 16, 1923 (P.L.207, No. 153).

maximum statutory interest rates of 12% and 10% are in the nature of a penalty.

This court must decide what *reasonable* interest rate would a secured creditor charge, as of the effective date of the plan, for a loan similar in character, amount, and duration. The hypothetical "creditor" contemplated by the Third Circuit's test in *GMAC v. Jones* was not a lien creditor, but rather a bank or other similar type of financial institution. Municipalities and counties such as the Claimants are not in the business of lending money, therefore, the "coerced loan" theory does not fit neatly. However, this court believes that the "coerced loan" theory can apply to the Claimants if the interest rate reflects the reasonable cost of interest to the municipality and the county, as of the effective date of the plan, over a 60 month period.

The market rate of interest for a municipal creditor varies from the rate charged by a consumer or commercial lender because municipal interest is free of federal tax to the owner. Bond rating agencies such as Moody's Investment Service and Standard & Poor's, Inc. rate municipalities; rates which vary depending on the credit worthiness, the administration and revenue of municipality. Daily trade publications such as the *Bond Buyer* publish the historical interest rates for municipal bonds.

This court believes that such interest rates best reflect a "loan similar in character" under these circumstances. The Debtors may apply such appropriate interest rates, as published in the *Bond Buyer* or a like publication, for debt with a 5 year term or longer for a "AA" rated county (for Allegheny County) and an "A" rated municipality (for

Penn Hills). In this case, the *Bond Buyer* index reported that the interest rate as of November 17, 1993 was 4.05% for a "AA" rated county and 4.30% for an "A" rated municipality. Thus, the court determines that 4.05% and 4.30%, respectively, are the "present value" of the Claimants' secured claims for the purposes of 11 U.S.C. § 1325(a)(5)(B)(ii). Therefore, 4.05% is the lowest interest rate the Debtors can propose to pay Allegheny County postpetition and 4.30% is the lowest interest rate the Debtors can propose to pay Penn Hills and the School District postpetition. The court takes judicial notice of these interest rates.

The Debtors have proposed a Chapter 13 plan that will pay the Claimants 7% interest on their respective postpetition claims. The Debtors asserted in court and in their briefs that this rate of interest is reasonable. Because 7% is more than 4.05% and 4.30%, the court finds in favor of the Debtors.

An appropriate Order is attached.

Dated this 13 day of May, 1994

at Pittsburgh, Pennsylvania

/s/ Joseph L Cosetti
Joseph L. Cosetti
U. S. Bankruptcy Judge

cc: Gary J. Gaertner, Esq.
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IN THE UNITED STATES BANKRUPTCY COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA

IN RE:	)	
SAMUEL AND ALICE DESARNO,	)	Bankruptcy No. 93-22234 JLC
Debtors/Movants,	)	Chapter 13
vs.	)	
COUNTY OF ALLEGHENY,	)	
Respondent.	)	

ORDER OF COURT

AND NOW, this 13 day of May, 1994, IT IS HEREBY ORDERED, ADJUDGED and DECREED that for the reasons stated in the Memorandum Opinion dated the same, the debtors Samuel and Alice DeSarno, shall pay Allegheny County prepetition interest in the amount of 12% on its secured claim. 72 Pa.C.S.A. § 5648. It is further,

ORDERED that the Debtors shall pay the Municipality of Penn Hills and the School District of Penn Hills prepetition interest in the amount of 10% on its secured claim. 53 Pa.C.S.A. § 7143. It is further,

ORDERED that pursuant to 11 U.S.C. § 1322(b)(2), the Debtors may properly modify the postpetition claims of Allegheny County, the Municipality of Penn Hill and the School District of Penn Hills (collectively "Claimants"). It is further,

ORDERED that in accordance with 11 U.S.C. § 1325(a)(5)(B)(ii), the Debtors may pay the Claimants

postpetition interest in the amount of 7% as proposed in their Chapter 13 plan.

At Pittsburgh, Pennsylvania.

/s/ Joseph L. Cosetti
Joseph L. Cosetti
U. S. Bankruptcy Judge

cc: Gary J. Gaertner, Esq.
Daniel J. Gates, Esq.
Daniel L. Haller, Esq.
Catherine T. Martin, Esq.
Michael G. McCabe, Esq.

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA
PITTSBURGH DIVISION

IN RE:	)	**CASE NO.:**
SAMUEL M. DESARNO	)	**93-22234 JLC**
AND ALICE DESARNO,	)	**CHAPTER 13**
DEBTORS.	)	

ORDER AND SECOND AMENDED CHAPTER 13 PLAN

I. PROPERTIES AND FUTURE EARNINGS SUBJECT TO THE SUPERVISION AND CONTROL OF THE TRUSTEE:

1. The DEBTOR(S) submit to the supervision and control of the TRUSTEE all or such portion of the DEBTOR(S)' future earnings or other future income as is necessary for the execution of the Plan, including:

a. The total amount which shall be paid to the TRUSTEE from future earnings is as follows:

MONTHS 1 - 3: $945.00 PER MONTH;
MONTHS 4 - 60: $975.00 PER MONTH.

b. Other property: NONE.

c. Amounts necessary for the payment of Class Five claims: NONE.

II. DURATION:

It is proposed that payments shall be made over a period of 60 months.

III. CLASSIFICATION AND TREATMENT OF CLAIMS:

1. **CLASS ONE** – CLAIMS ENTITLED TO PRIORITY under Section 507, Title 11, United States Code. Unless other provision is made in Paragraph IV, the creditors in CLASS ONE shall be paid contemporaneous with distributions to other classes. The payments to the TRUSTEE shall be made by deduction from each payment made by the DEBTOR(S) to the TRUSTEE. The DEBTOR(S) will pay CLASS ONE claims in full in deferred cash payments as follows:

a. Allowed administrative expenses:

1. Trustee's Compensation: 10% OF AMOUNTS PAID INTO PLAN BY DEBTOR(S).

GARY J. GAERTNER, ESQUIRE
SUITE 2900, GULF TOWER
707 GRANT STREET
PITTSBURGH, PENNSYLVANIA 15219
(412) 471-5566

2. Attorney's Fees: $1,250.00 total at $125.00 per month for months 1 - 10. After payments end, amount applied to CLASS 2 payments.

LAW OFFICES OF DANIEL J. GATES, P.C.
828 FRICK BUILDING
PITTSBURGH, PENNSYLVANIA 15219
(412) 471-9610

b. Taxes: THE SUM OF $521.19 SHALL BE PAID TO THE TREASURER, ALLEGHENY COUNTY AS FULL PAYMENT OF ALL PRIORITY REAL ESTATE

TAXES OWED. NO FURTHER INTEREST OR PENALTIES SHALL ACCRUE ON THIS OBLIGATION DURING THE TERM OF THE PLAN. PAYMENTS SHALL BE MADE TO THIS CREDITOR IN MONTHS 1 - 60.

THE SUM OF $1,140.04 SHALL BE PAID TO THE TREASURER, ALLEGHENY COUNTY AS FULL PAYMENT OF ALL SECURED REAL ESTATE TAXES OWED BY THE DEBTORS. INTEREST ON THIS OBLIGATION SHALL BE PAID AT 7.0%. NO FURTHER PENALTIES SHALL ACCRUE ON THIS OBLIGATION DURING THE TERM OF THE PLAN. PAYMENTS SHALL BE MADE TO THIS CREDITOR IN MONTHS 1 - 60.

THE SUM OF $687.99 SHALL BE PAID TO THE PENN HILLS MUNICIPALITY C/O CENTRAL TAX BUREAU, AS FULL PAYMENT OF ALL SECURED REAL ESTATE TAXES OWED. INTEREST SHALL BE PAID AT THE RATE OF 7.0%. NO FURTHER PENALTIES SHALL ACCRUE ON THIS OBLIGATION DURING THE TERM OF THE PLAN. PAYMENTS SHALL BE MADE TO THIS CREDITOR IN MONTHS 1 - 60.

THE SUM OF $1,435.24 SHALL BE PAID TO THE SCHOOL DISTRICT OF PENN HILLS, AS FULL PAYMENT OF ALL PRIORITY REAL ESTATE TAXES OWED FOR YEARS 1991 - 1993. NO FURTHER INTEREST OR PENALTIES SHALL ACCRUE ON THIS OBLIGATION DURING THE TERM OF THE PLAN. PAYMENTS SHALL BE MADE TO THIS CREDITOR IN MONTHS 1 - 60.

THE SUM OF $1,548.10 SHALL BE PAID TO THE SCHOOL DISTRICT OF PENN HILLS, AS FULL SATISFACTION OF ALL SECURED TAXES OWED BY THE DEBTORS. INTEREST SHALL BE PAID ON THIS OBLIGATION AT THE RATE OF 7.0%. NO FURTHER PENALTIES SHALL ACCRUE ON THIS DEBT DURING THE TERM OF THE PLAN.

THE SUM OF $250.43 SHALL BE PAID TO THE MUNICIPALITY OF PENN HILLS AS FULL SATISFACTION OF ALL PREPETITION WAGE TAXES OWED BY THE DEBTORS. INTEREST SHALL BE PAID AT THE RATE OF 7.0%. NO FURTHER PENALTIES SHALL ACCRUE ON THIS DEBT DURING THE TERM OF THE PLAN.

c. Others (if any): NONE.

2. CLASS TWO – CLAIMS SECURED BY PERSONAL RESIDENCE – claims set forth below are secured only by an interest in real property that is the DEBTOR(S)' principal residence.

I. NAME AND ADDRESS OF CREDITOR:

ASSOCIATES FINANCIAL SERVICES COMPANY, INC.
POST OFFICE BOX 191
MONROEVILLE, PENNSYLVANIA 15146

1. CURE OF DEFAULT:

AMOUNT OF DEFAULT: $8,860.00

AMOUNT TO BE PAID TO CURE DEFAULT: $0 (ARREARS TO BE DEFERRED).

NUMBER OF MONTHS: 60.

BEGINNING IN MONTH # 1 AND EXTENDING TO MONTH # 60.

MORTGAGE ARREARS OWED BY THE DEBTORS SHALL NOT BE PAID DURING THE TERM OF THE PLAN AND THE REPAYMENT NOTE BETWEEN THE PARTIES SHALL BE EXTENDED TO ACCOMMODATE REPAYMENT OF THE ARREARS AT THE END OF THE ORIGINAL TERM OF THE MORTGAGE NOTE.

2. REGULAR MONTHLY PAYMENT – $624.15, to be paid by Trustee. (Is included above.) Regular monthly payment extends beyond the term of this Plan.

The amount to be paid to cure the default shall be paid in full before distribution to creditors in CLASSES THREE, FOUR AND FIVE are made. After the amount in default is paid in full, the remaining amounts shall be applied to cure the default in the claim of the next CLASS TWO secured creditor:

___.

II. NAME AND ADDRESS OF CREDITOR:

ASSOCIATES FINANCIAL SERVICES COMPANY, INC.
POST OFFICE BOX 191
MONROEVILLE, PENNSYLVANIA 15146

1. CURE OF DEFAULT:

AMOUNT OF DEFAULT: $3,560.00

AMOUNT TO BE PAID TO CURE DEFAULT: $3,560.00

NUMBER OF MONTHS: 60.

BEGINNING IN MONTH # 1 AND EXTENDING TO MONTH # 60.

2. PAYMENT OF OUTSTANDING PRINCIPAL BALANCE:

TOTAL TO BE PAID: $4,440.00

INTEREST TO BE PAID: 9.0%

MONTHLY PAYMENT AMOUNT: $92.17

NUMBER OF MONTHS: 60.

THE TERMS OF REPAYMENT TO THIS CREDITOR ARE EXPRESSLY MODIFIED PURSUANT TO 11 U.S.C. SECTION 1322. UPON PAYMENT IN ACCORDANCE WITH THE FOREGOING TERMS, THE CREDITOR SHALL PROMPTLY SATISFY, RELEASE AND DISCHARGE ALL MORTGAGES AND LIENS ENCUMBERING PROPERTY OF THE DEBTORS.

3. CLASS THREE – THE ALLOWED SECURED CLAIMS (other than CLASS TWO claims) shall be dealt with as follow:

A. COLLATERAL RETAINED BY DEBTOR(S) SUBJECT TO LIENS:

NAME AND ADDRESS OF CREDITOR	COLLATERAL
NONE.	

TOTAL DUE: _____

AMOUNT PER MONTH: _____

NUMBER OF MONTHS: ___

BEGINNING IN MONTH # ___ AND EXTENDING TO MONTH # ___.

506 ACTION PENDING:? ___

After payments are completed, the funds formerly paid to the above creditor shall be applied to the next in line creditor.

B. The DEBTOR(S) shall surrender the property securing the liens of the following creditors:

CREDITOR	PROPERTY

NONE.

4. CLASS FOUR - ALLOWED UNSECURED CLAIMS not otherwise referred to in the Plan. CLASS FOUR claims are provided for and shall be paid as follows:

ALL CLAIMS DULY PROVEN AND ALLOWED SHALL SHARE PRO RATA IN THE FUND DERIVED FROM PLAN PAYMENTS ONCE ALL ADMINISTRATIVE CLAIMS ARE PAID AND ALL SECURED ARREARS ARE CURED.

The approximate percentages of CLASS FOUR CLAIMS to be paid under this Plan is 0%.

5. CLASS FIVE - POST-PETITION CLAIMS allowed under Section 1305, Title 11, United States Code shall be paid as follows:

NONE.

IV. OTHER PROVISIONS:

1. The following executory contracts and unexpired leases are rejected:

NONE.

2. The effective date of this Plan shall be the date of entry of the Order confirming this Plan. Nonetheless, the DEBTOR(S) is obligated to make regular monthly payments prior to confirmation under 11 U.S.C. Section 1326.

3. Other: THE DEBTORS SHALL PROSECUTE A MOTION TO AVOID THE JUDICIAL LIEN HELD BY BANK ONE TO THE EXTENT THAT THE DEBTORS ARE NOT SUCCESSFUL IN SAID ACTION, THEY SHALL AMEND THE PLAN.

V. REVESTMENT OF PROPERTY IN DEBTOR(S):

Property of the estate shall vest in the DEBTOR(S) at the time of confirmation of this Plan, unless stated to the contrary below:

N/A.

VI. CONTINGENT UPON A RESOLUTION SALES TAX ISSUE CLAIM.

VII. CONTINGENT ON THE INTEREST RATE ISSUE OF ALLEGHENY & PENN HILLS.

Respectfully submitted,

LAW OFFICES OF DANIEL J. GATES, P.C.

DATE: NOV. 8, 1993.

By: /s/ Daniel J. Gates
Daniel J. Gates, Esquire
Attorney for the Debtors.
828 Frick Building
Pittsburgh, Pennsylvania
15219
(412) 471-9610
PA I.D. # 55330

SO ORDERED: 17 Nov. ~~1994~~ 1993

/s/ J.L. Cosetti
UNITED STATES BANKRUPTCY JUDGE

11 USCS § 1322. Contents of plan

(a) The plan shall –

(1) provide for the submission of all or such portion of future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan;

(2) provide for the full payment, in deferred cash payments, of all claims entitled to priority under section 507 of this title, unless the holder of a particular claim agrees to a different treatment of such claim; and

(3) if the plan classifies claims, provide the same treatment for each claim within a particular class.

(b) Subject to subsections (a) and (c) of this section, the plan may –

(1) designate a class or classes of unsecured claims, as provided in section 1122 of this title, but may not discriminate unfairly against any class so designated; however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims,

(2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims;

(3) provide for the curing or waiving of any default;

(4) provide for payments on any unsecured claim to be made concurrently with payments on any secured claim or any other unsecured claim;

(5) notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due;

(6) provide for the payment of all or any part of any claim allowed under section 1305 of this title;

(7) subject to section 365 of this title, provide for the assumption, rejection, or assignment of any executory contract or unexpired lease of the debtor not previously rejected under such section;

(8) provide for the payment of all or part of a claim against the debtor from property of the estate or property of the debtor;

(9) provide for the vesting of property of the estate, on confirmation of the plan or at a later time, in the debtor or in any other entity; and

(10) include any other appropriate provision not inconsistent with this title

(c) Notwithstanding subsection (b)(2) and applicable nonbankruptcy law –

(1) a default with respect to, or that gave rise to, a lien on the debtor's principal residence may be cured under paragraph (3) or (5) of subsection (b) until such residence is sold at a foreclosure sale that is conducted in accordance with applicable nonbankruptcy law; and

(2) in a case in which the last payment on the original payment schedule for a claim secured only by a security interest in real property that is the debtor's principal residence is due before the date on

which the final payment under the plan is due, the plan may provide for the payment of the claim as modified pursuant to section 1325(a)(5) of this title.

(d) The plan may not provide for payments over a period that is longer than three years, unless the court, for cause, approves a longer period, but the court may not approve a period that is longer than five years.

(e) Notwithstanding subsection (b)(2) of this section and sections 506(b) and 1325(a)(5) of this title, if it is proposed in a plan to cure a default, the amount necessary to cure the default shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law.

(Nov. 6, 1978, P. L. 95-598, Title I, § 101, 92 Stat. 2648; July 10, 1984, P. L. 98-353, Title III, Subtitle A, § 316, Subtitle H, § 528, 98 Stat. 356, 389; Oct. 22, 1994, P.L. 103-394, Title III, §§ 301, 305(c), 108 Stat. 4131, 4134.)

11 USCS § 1325. Confirmation of plan

(a) Excerpt as provided in subsection (b), the court shall confirm a plan if –

(1) the plan complies with the provisions of this chapter and with the other applicable provisions of this title;

(2) any fee, charge, or amount required under chapter 123 of title 28 [28 USCS §§ 1911 et seq.], or by the plan, to be paid before confirmation, has been paid;
(3) the plan has been proposed in good faith and not by any means forbidden by law;

(4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the

amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;

(5) with respect to each allowed secured claim provided for by the plan –

(A) the holder of such claim has accepted the plan;

(B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder; and

(6) the debtor will be able to make all payments under the plan and to comply with the plan.

(b)(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan –

(A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or

(B) the plan provides that all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.

(2) For purposes of this subsection, "disposable income" means income which is received by the

debtor and which is not reasonably necessary to be expended –

(A) for the maintenance or support of the debtor or a dependent of the debtor; and

(B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

(c) After confirmation of a plan, the court may order any entity from whom the debtor receives income to pay all or any part of such income to the trustee.

(Nov. 6, 1978, P. L. 95-598, Title I, § 101, 92 Stat. 2649; July 10, 1984, P. L. 98-353, Title III, Subtitle A, § 317, Subtitle H, § 530, 98 Stat. 356, 389; Oct. 27, 1986, P.L. 99-554, Title II, Subtitle C, § 283(y), 100 Stat. 3118.)